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BOARD OF EQUALIZATION

STATE OF CALIFORNIA

In the Matter of the Appeal of:	**HEARING SUMMARY**[1]
	PERSONAL INCOME TAX APPEAL
FR. BISHOY ABDEL AND	Case No. 600054
NIVEN A. ESCAN	

Year	Proposed Assessment
2004	$ 2,845[2]

Representing the Parties:

For Appellants: Doug S. Noonan, Certified Public Accountant

For Franchise Tax Board: Cynthia D. Kent, Tax Counsel IV

QUESTIONS: (1) Whether appellants have shown error in respondent's proposed assessment that

[1] This matter has been postponed twice. This matter was originally scheduled for the March 25, 2014 Board meeting, but was postponed at the request of appellants' representative and rescheduled for the May 22, 2014 Board meeting. This matter was then postponed to the July 17-18, 2014 Board meeting at appellants' request.

[2] This is the amount listed on the original Notice of Action. During the course of this appeal, respondent indicated that it will reduce the proposed assessment of additional tax to $2,605. Appellants appear to agree with respondent's revised calculation of the proposed additional tax amount.

Respondent acknowledges that it received a payment of $2,581 on January 13, 2012. Respondent indicates that the balance due as of March 25, 2014, is $1,317.50. Respondent should be prepared to provide the current balance due as of the date of this hearing.

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was based on a final federal determination; and

(2) Whether interest may be abated.

HEARING SUMMARY

Background

Appellants filed a timely California tax return for the 2004 tax year. On the return, appellants reported a California adjusted gross income (AGI) of a loss of $47,505, claimed total deductions of $23,442, and a taxable income of a loss of $70,947. Appellants claimed personal and dependent exemption credits of $700 and reported a self-assessed tax of zero. (Resp. Op. Br., p. 1, Exhs. A & B.)

Subsequently, the Internal Revenue Service (IRS) audited appellants' 2004 federal tax return and made adjustments to appellants' income, which increased appellants' federal taxable income for the 2004 tax year. Appellants did not notify respondent of the federal adjustments. Respondent received information regarding the federal adjustments on August 8, 2008. (Resp. Op. Br., p. 1, Exh. C.)

Based on this information, respondent issued a Notice of Proposed Assessment (NPA) for the 2004 tax year on July 20, 2009. The NPA followed the federal adjustments and adjusted appellants' taxable income by a total of $218,054.[3] The adjustments increased appellants' taxable income from a loss of $70,947 to $147,107, resulting in a tax of $9,729. After applying appellants' personal and dependent exemption credits of $700.00, respondent proposed additional tax due of $9,029.00, and an accuracy-related penalty of $1,805.80, plus interest. (Resp. Op. Br., p. 2, Exh. D.)

Appellant protested the NPA on or about July 30, 2009, contending that the federal determination was not final. Respondent agreed to defer the matter pending the final federal determination. According to respondent, contact was made periodically between appellants and respondent through correspondence and telephone regarding the status of the federal audit reconsideration. On November 14, 2011, appellant provided respondent with a copy of federal

[3] This amount represents the following: (1) a $134,598 increase in Schedule C gross receipts or sales; (2) a $59,871 disallowance of Schedule C advertising expenses; (3) a $11,438 disallowance of an NOL carryover; (4) a $298 disallowance of Schedule A miscellaneous deductions; and (5) a $11,849 disallowance of Schedule A medical deductions.

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Form 4549, Income Tax Examination Changes, dated September 14, 2010, as well as a copy of the first two pages of their federal return for the 2004 tax year. (Resp. Op. Br., p. 2, Exh. E.)

Respondent reviewed Form 4549 which revised the initial federal determination. Respondent issued a Notice of Action (NOA) on December 29, 2011, allowing appellants additional Schedule C deductions of $22,441, and reduced appellant-husband's income from his employment as a priest by $44,041. This reduced appellants' total California adjustments from $218,054 to $151,572.[4] The adjusted amount increased appellants' taxable income from the reported loss of $70,947 to a revised taxable income of $80,625, resulting in tax of $3,545. After applying appellants' personal and dependent exemptions of $700, the NOA proposed additional tax of $2,845, plus interest. Respondent also withdrew the accuracy-related penalty because the IRS abated the federal accuracy-related penalty. (Resp. Op. Br., p. 2, Exh. E; Appeal Letter, Atth.)

This timely appeal then followed.

Contentions

Appellants' Appeal Letter

Appellants contend that the revised taxable income of $80,625 is incorrect. Appellants contend that Form 4549 reflects the revised taxable income should be $63,148 which reduces the tax liability to $1,768 and interest of $813. Appellants submitted a payment of $2,581 with their appeal letter. (Appeal Letter, p.1, Atths.)

Respondent's Opening Brief

Respondent contends that appellants failed to establish error in the proposed assessment. Respondent contends that a deficiency assessment based on a federal audit report is presumptively correct and appellants bear the burden of proving it erroneous. Respondent contends that a taxpayer's unsupported assertions will not satisfy his or her burden of proof. Respondent contends that it followed the federal adjustments to the extent California law allows, based on the initial RAR dated January 29, 2008, and the revised federal audit report dated September 14, 2010, as well as the initial deficiency

[4] The $151,572 increase (i.e., $218,054 - $22,441 - $44,041) in appellants' taxable income is composed of the following: $218,054 (in adjustments reflected on the NPA) - $22,441 (for the allowance of additional Schedule C deductions) - $44,041 (a reduction in appellant-husband's income as a priest).

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assessment posted to appellants' federal transcript of $26,361. Respondent contends that its review of a revised federal transcript does not show that the IRS abated any additional federal tax or that there are any claims pending. (Resp. Op. Br., p. 3, Exhs. C, E & G.)

Respondent asserts that appellants' contention, that the correct taxable income should be $63,148, fails to take into consideration the differences between federal and state law. Respondent contends that, for federal purposes, appellants' return reported an AGI of a loss of $60,020, and claimed itemized deductions of $25,519, and exemption credits of $12,400 for a total taxable income of a loss of $97,939. Respondent further notes that, following the initial exam, the IRS audit adjustments totaled $227,950, which increased appellants' federal taxable income from the reported loss of $97,939 to $130,011. This resulted in additional federal income tax due of $26,361. Respondent notes that, as a result of the federal audit reconsideration, appellants were allowed additional adjustments to income of $66,863. Respondent notes that, when this amount is subtracted from appellants' previously adjusted income of $130,011, the resultant final taxable income at the federal level is $63,148. The resultant corrected federal tax liability is $7,256, a reduction of tax of $19,105. (Resp. Op. Br., p. 4, Exhs. C, G & E.)

Respondent contends that, for California purposes, appellants' return also reported an AGI of a loss of $60,020. Respondent contends that, due to differences between state and federal law, appellants reported California subtractions of $11,438 and California additions of $23,953, for a California AGI of a loss of $47,505. Respondent notes that appellants' California return claimed California itemized deductions of $23,442 and exemption credits of $700, for a total California taxable income of a loss of $70,947. Respondent contends that, following receipt of the RAR, respondent made adjustments where applicable to California, totaling $218,054 to appellants' California taxable income. Respondent contends that this resulted in a revised taxable income of $147,107, and a tax of $9,729. Respondent applied the exemption credits of $700, and issued the NPA for additional tax of $9,029, plus interest. (Resp. Op. Br., p. 4, Exhs. B, C & D.)

Respondent notes that, in accordance with the revised federal report where applicable to the California return, it allowed additional adjustments to income of $66,482. As such, respondent reduced the additional adjustments as shown on the NPA from $218,054 to $151,572 as shown on the

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NOA. When the additional adjustments of $151,572 were added to the California taxable income, a loss of $70,947, the final corrected California taxable income is $80,625. Respondent notes that the resulting tax is $3,545, and after applying the personal and exemption credits of $700, the NOA proposed additional tax of $2,845, plus interest. As such, respondent contends that it properly calculated the proposed additional tax based on the final federal determination. (Resp. Op. Br., pp. 4-5, Exh. E, Appeal Letter, Atth.)

Appellants' Reply Brief

Appellants state that they do not agree with the proposed changes to their tax. Appellants submit a prepared copy of their 2004 California tax return and federal tax return purportedly reflecting the federal adjustments in the Form 4549. Appellants contend that their calculation shows that they are due a refund of $136. (App. Reply Br., p. 1, Atths.)

Respondent's Reply Brief

Respondent contends that appellants' prepared California return contains several errors. Respondent contends that the federal AGI reported in the revised California return of $85,248 is incorrect. Respondent contends that this amount is incorrect because appellant's prepared federal tax return was not prepared with the amounts from appellants' original federal tax return and then incorporating the federal adjustments. Respondent contends that the prepared federal tax return seems to be prepared to result in taxable income of $63,148, as reported on the Form 4549. Respondent contends that, in doing so, the prepared federal return fails to report the correct federal AGI of $88,920 or the correct itemized deductions of $13,372. Respondent contends that the prepared federal return reports the standard deduction and then a "lump sum" other income amount to achieve the desired taxable income amount. Respondent contends that this error results in an erroneous lower federal AGI which was then used in appellants' prepared California return and resulting in a lower tax of $2,709. Respondent further contends that appellants incorrectly report payments of $2,845 on their prepared California tax return, when appellants only remitted $2,581 with the filing of this appeal. Respondent submitted a prepared corrected pro forma federal and California tax returns incorporating the final federal determinations to illustrate its contentions. (Resp. Reply Br., pp. 1-2, Exh. H.)

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Appellants' Supplemental Brief

Appellants state that they agree with respondent's corrected pro forma returns except for respondent's inclusion of a $3,000 capital loss to appellants' income reflected in the Schedule CA. Appellant contends that no adjustment is needed for this item because there is no difference between federal and California law regarding the basis of the asset sold. Appellants further state that they made a payment of $2,581 in January 2012. Appellants contend that, when that payment is taken into account, the tax owed is reduced to $24. Appellants submit a second prepared California return reflecting the change to the capital loss and the instructions to the Schedule CA to support their position that the capital loss should not be added back to income. (App. Supp. Br., p. 1, Atths.)

Appellants also contend that penalties[5] and interest should be abated. Appellants contend that appellant-husband relied on their tax preparer to correctly prepare the 2004 tax return. Appellants contend that the tax preparer, and not appellants, should be penalized. Appellants contend that appellant-husband helps the poor in his community and it doesn't seem fair to charge him interest based on his reliance on the tax preparer. (App. Supp. Br., p. 1.)

Respondent's First Supplemental Brief

Respondent agrees that it incorrectly adding the $3,000 capital loss into income. Respondent has indicated that it will allow the $3,000 capital loss and agree that the correct tax is $2,605 for the 2004 tax year as reflected on the pro forma return appellants provided with their supplemental brief. Respondent states that it will credit appellants' payment of $2,581 to appellants' 2004 tax year account upon the resolution of this appeal. (Resp. 1st Supp. Br., pp. 1-2.)

As to appellants' request for interest abatement, respondent contends that interest may not be abated upon reasonable cause arguments. As such, respondent contends that it may not abate interest in this matter based on appellants' good faith reliance on their tax preparer. Respondent notes that it may abate interest under R&TC section 19104 if a taxpayer shows that there is an unreasonable error or delay in respondent's performance of a ministerial or managerial act occurring after respondent's first written contact with the taxpayer. Respondent contends that appellants have not

[5] No penalties are currently imposed in this matter.

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shown such error or delay in this matter. (Resp. 1st Supp. Br., p. 2.)

Respondent's Second Supplemental Brief

Respondent provides a breakdown of the tax and interest in this appeal. Respondent notes that the additional tax at issue is $2,605. Respondent notes that the amount of interest that accrued from April 15, 2005 to January 13, 2012, is $1,203.87. Respondent acknowledges that it received appellants' payment of $2,581 on January 13, 2012. Respondent also notes that the amount of interest that accrued from January 13, 2012 to March 25, 2014,[6] is $89.63. As such, the balance due as of March 25, 2014, was $1,317.50. Respondent reiterates that appellants have not shown an error or delay in the performance of a ministerial or managerial act by respondent or the IRS occurring after the first contact with appellants. (Resp. 2nd Supp. Br., p. 1.)

Respondent also addresses appellants' question regarding the statute of limitations. Respondent notes that the initial federal assessment date is June 30, 2008. Respondent received a notification of the assessment from the IRS on August 8, 2008. Respondent issued the NPA on July 20, 2009. Respondent contends that it has two years from August 8, 2008, to issue a timely assessment, citing R&TC section 19059. Respondent contends that its NPA issued on July 20, 2009 was timely. (Resp. 2nd Supp. Br., pp. 2-3.)

Applicable Law

Burden of Proof

The FTB's determination is presumed correct and an appellant has the burden of proving it to be wrong. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.) In the absence of uncontradicted, credible, competent, and relevant evidence showing an error in the FTB's determinations, respondent's determinations will be upheld. (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.)

Federal Assessment

R&TC section 18622, subdivision (a), provides that a taxpayer shall either concede the accuracy of a federal determination or state wherein it is erroneous. It is well-settled that a deficiency assessment

[6] March 25, 2014 was the original scheduled Board hearing date for this appeal.

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based on a federal audit report is presumptively correct and that an appellant bears the burden of proving that the determination is erroneous. (*Appeal of Sheldon I. and Helen E. Brockett*, 86-SBE-109, June 18, 1986; *Todd v. McColgan* (1949) 89 Cal.App.2d 509.) Unsupported assertions are not sufficient to satisfy an appellant's burden of proof with respect to an assessment based on a federal action. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.)

Interest Abatement

Interest is not a penalty but is merely compensation for a taxpayer's use of the money. (Rev. & Tax. Code, § 19101, subd. (a); *Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977; *Appeal of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.) There is no reasonable cause exception to the imposition of interest. (*Appeal of Audrey C. Jaegle, supra*.)

Under R&TC section 19104, subdivision (a)(1), respondent may abate all or a part of any interest on a deficiency to the extent that interest is attributable in whole or in part to any unreasonable error or delay committed by respondent in the performance of a ministerial or managerial act. An error or delay can only be considered when no significant aspect of the error or delay is attributable to the appellant and after respondent has contacted the appellant in writing with respect to the deficiency or payment. (Rev. & Tax. Code, § 19104, subd. (b)(1).)

In the *Appeal of Michael and Sonia Kishner*, 99-SBE-007, decided on September 29, 1999,[7] the Board adopted the language from Treasury Regulation section 301.6404-2(b)(2), defining a "ministerial act" as:

> [A] procedural or mechanical act that does not involve the exercise of judgment or discretion, and that occurs during the processing of a taxpayer's case after all prerequisites to the act, such as conferences and review by supervisors, have taken place. A decision concerning the proper application of federal tax law (or other federal or state law) is not a ministerial act.

When a California statute is substantially identical to a federal statute (such as with the interest abatement statute in this case),[8] the Board may consider federal law interpreting the federal

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[7] Board of Equalization cases are generally available for viewing on the Board's website (http://www.boe.ca.gov/legal/legalopcont.htm).

[8] R&TC section 19104, subdivisions (a) and (b)(2)(B), are substantially identical to IRC section 6404, subsections (e) and (h).

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statute as highly persuasive. (*Appeal of Michael and Sonia Kishner, supra*, (citing *Douglas v. State of California* (1942) 48 Cal.App.2d 835.)) In this regard, Treasury Regulation section 301.6404-2(b)(1) defines a "managerial act" as:

> [A]n administrative act that occurs during the processing of a taxpayer's case involving the temporary or permanent loss of records or the exercise of judgment or discretion relating to management of personnel. A decision concerning the proper application of federal tax law (or other federal or state law) is not a managerial act.

A decision concerning the proper application of federal tax law, or other federal or state laws, to the facts and circumstances surrounding a taxpayer's tax liability is not a ministerial or managerial act. (Treas. Reg. § 301.6404-2(b); *Bucaro v. Comm'r*, T.C. Memo 2009-247.) Tax Courts have held that the decision to examine, or not to examine, a taxpayer's income tax return for a particular taxable year involves the exercise of judgment and discretion and, therefore, is not a ministerial act. (*Pettyjohn v. Comm'r*, T.C. Memo 2001-227.)

Respondent's determination not to abate interest is presumed correct, and the burden is on an appellant to prove error. (*Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.) The Board's jurisdiction in an interest abatement case is limited by statute to a review of respondent's determination for an abuse of discretion. (Rev. & Tax. Code, § 19104, subd. (b)(2)(B).) To show an abuse of discretion, an appellant must establish that, in refusing to abate interest, respondent exercised its discretion arbitrarily, capriciously, or without sound basis in fact or law. (*Woodral v. Commissioner* (1999) 112 T.C. 19, 23.)

STAFF COMMENTS

During this appeal, appellants indicated that they agree with the adjustments reflected in respondent's corrected pro forma return, except for the disallowed $3,000 capital loss. (Resp. Reply Br., Exh. H; App. Supp. Br., p. 1.) Respondent subsequently determined that it incorrectly disallowed the $3,000 loss on the Schedule CA by adding the $3,000 back into income.[9] Respondent has indicated that it will allow the $3,000 capital loss and reduce the proposed assessment of additional tax to $2,605, plus interest. (Resp. 1st Supp. Br., p. 1.) Thus, the parties appear to agree on the revised additional tax

[9] This error was also included in appellants' originally-filed California Schedule CA. (Resp. Op. Br., Exh. B.)

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amount of $2,605.

However, the parties dispute whether appellant is entitled to interest abatement. Staff notes that appellants state that it would be unfair to impose interest on them because they relied on their tax preparer to properly prepare their tax returns. Appellants further state that it would be unfair as appellant-husband, as a priest, provides support to his congregation and the poor. Staff notes that there is no reasonable cause exception to the imposition of interest. (*Appeal of Audrey C. Jaegle, supra*.) Pursuant to R&TC section 19104, appellants should be prepared to discuss, and provide evidence of, an unreasonable error or delay made by respondent in a ministerial or managerial act which occurred after respondent's first written contact. It appears to staff that respondent's first written contact to appellants regarding the 2004 tax year occurred on July 20, 2009, the date respondent issued the NPA for this tax year. Appellants should further be prepared to discuss whether respondent abused its discretion in refusing to abate interest. (Rev. & Tax. Code, § 19104, subd. (b)(2)(B).)

If either party has any additional evidence to present, they should provide their evidence to the Board Proceedings Division at least 14 days prior to the oral hearing pursuant to California Code of Regulations, title 18, section 5523.6.[10]

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[10] Evidence exhibits should be sent to: Khaaliq Abd'Allah, Appeals Analyst, Board Proceedings Division, State Board of Equalization, P.O. Box 942879 MIC: 80, Sacramento, California, 94279-0080.

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